DOCKET SECTION

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE AND FEE CHANGES, 1997) Docket No. R97-1

RESPONSE OF NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.
TO INTERROGATORIES
OF UNITED STATES POSTAL SERVICE (USPS/NDMS-T2-1-5)
(January 26, 1998)

Pursuant to sections 25 and 26 of the Postal Rate Commission rules of practice, Nashua Photo Inc., District Photo Inc., Mystic Color Lab, and Seattle FilmWorks, Inc., hereby provide the responses of witness John Haldi to the following interrogatories of the United States Postal Service: USPS/NDMS-T2-1-4, filed on January 12, 1998, and USPS/NDMS-T2-5, filed on January 22, 1998. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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USPS/NDMS-T2-1.

Please refer to pages 68-69 of your testimony, in which you note that Priority Mail is being charged with the entire Phase I cost for the PMPC network during the test year.

(a) Please confirm that the cost of operating the new PMPC network in the test year will be incurred entirely on behalf of Priority Mail. If not confirmed, please explain fully to which class or classes of mail these costs relate.

(b) Is it your position that the entire Phase I cost for the PMPC network during the test year should not be charged to Priority Mail? If so, please explain fully to which classes of mail this cost should be charged, why, and in what manner.

Response:

(a) Confirmed.

(b) No. It would not be wrong to attribute the test year costs of the PMPC contract to Priority Mail. On the other hand, when private industry undertakes the startup of a major initiative with long-term consequences and payout, it is sometimes deemed appropriate to capitalize some of the initial start-up expense, and write off the capitalized amount over future years. My point is that since the Postal Service has elected to charge off all start-up expenses as incurred, and concurrently impose a high markup on Priority Mail during the test year, the coverage certainly should not be any higher than that proposed. Also note that, as stated in my testimony (NDMS-T2, p. 74, l. 10 to p. 77, l. 14), the prospective test year net cost estimates for Priority Mail appear to be overstated.

USPS/NDMS-T2-2.

On page 63, line 14 of your testimony you state that "whatever value the PMPCs may have in ultimate improvement of delivery service, if any, will certainly not materialize until some time after the test year".

(a) Please provide fully the basis for this statement.

(b) Is it possible that the implementation of the PMPC network will improve Priority Mail Service before the end of the test year? If this is not possible, please explain why.

(c) Is it possible that the introduction of the PMPC network will improve Priority Mail service at some time after the test year? If this is not possible please explain why.

<u>Response</u>:

(a) First of all, it is my understanding that only one-third of Priority Mail will come in any contact with the PMPC network during the test year, and that of that third, only one-third will both originate and destinate within the PMPC network. Even if there were an improvement in handling Priority Mail as a result of the PMPC network, it is virtually impossible that such an improvement could significantly affect the overall service and performance of Priority Mail in the test year.

Second, the stated service goal of 96.5 percent on-time (2-day) performance for the PMPC contract is not measured from time of entry to time of delivery, but from when the Postal Service tenders the mail to Emery to when Emery tenders it back to the Postal Service. APMU/USPS-T33-3 (Tr. 4/1929). Presumably Emery would endeavor to tender this mail back to the

Postal Service in time for delivery on the second day, but while the results remain to be seen, there may be more Priority Mail delivered in a 3-day period as a result of the PMPC contract.

Third, the Phase I area has only 10 PMPCs, through which all Priority Mail within the designated area must be routed, including "local" overnight mail in urban areas not close to the 10 centers (*e.g.*, Tallahassee, Tampa, and Fort Myers in Florida, or Burlington, Vt., Albany, N.Y., Springfield, Mass., and Portland, Me. in the Northeast). If local Priority Mail (deposited before 5 p.m.) within such cities no longer receives next day delivery, service will have perforce declined from existing levels. "Massing of the mail" within fewer centers can and often does have a serious negative impact on service performance for what normally should be next-day delivery. See, for example, the testimony of witness Patsy Speights (NNA-T2). If the Postal Service reduces the volume of Priority Mail that receives delivery in 3 or more days, while also reducing the volume of local mail that receives overnight delivery by an equal or greater amount, the Postal Service should not claim that service has improved.

Last, Priority Mail drop-ship users apparently will no longer be able to enter plant loads directly at Airport Mail Centers, which will likely also cause Priority Mail service within the PMPC network area to deteriorate. See NDMS-T2, p. 67, ll. 4-17.

(b) Yes, service may improve, but it also is possible that service will be worse or stay the same. Without good performance measurement data, it will not be possible to ascertain what the level of service is. Furthermore, since no reliable data exist for the period before the PMPC contract took effect, it will not be possible to state whether service is any better on account of the contract.

(c) See response to (b).

USPS/NDMS-T2-3.

On page 76, line 10 of your testimony you state that "witnesses Tayman and Patelunas testified that the Postal Service would realize no cost savings for highway transportation because the truck contracts are fixed over a multi-year period, and reduced loads in the test year do not translate into cost savings for the Postal Service". You further reference witness Tayman's testimony that, "just because you take a certain amount of mail volume off of [trucks] that doesn't mean that the cost of that transportation goes down."

(a) Do you agree that during the test year the Postal Service will not realize cost savings for-highway transportation relating to implementation of the PMPC network? Please explain fully why or why not, including a discussion of all factors upon which such test-year cost savings may depend.

(b) Is it your position that such cost savings can only be incurred in years subsequent to the test year? Please explain your answer fully, including a discussion of all factors upon which such subsequent cost savings may depend.

(c) Is it your position that the Priority Mail rates to be recommended pursuant to this proceeding should be based on costs other than those incurred in the test year? Please explain your answer fully.

Response:

(a) No, I do not agree. It is my understanding that the duration of highway contracts is typically four years. (*See* Tr. 7/3839, ll. 14-16). Thus, during the test year approximately one-fourth of the existing highway transportation contracts, will expire and be subject to renegotiation. With 14,781 highway transportation contracts (as of August, 1996; *see* FGFSA/USPS-T-13-5 Tr. 7/3564), an average of 71 highway transportation contracts expire every week. Within the area served by the new PMPC network, the contracts can be renegotiated to take into account the fact that all Priority Mail has been removed from existing highway transportation. Moreover, on various occasions when it has served the Postal Service's purposes, the Postal Service has testified that it has considerable short-run flexibility to — by way of example — add extra runs on a route, or increase the size of vehicles. Removing Priority Mail from all existing highway transportation within the area served by the PMPC contract will help obviate the need to incur costs for any extra runs or larger vehicles, which should result in additional savings during the test year.

(b) No. The cost savings would be incurred in any year, including the test year, in which the truck contracts are revised or costs can be avoided as discussed in my response to (a). See also my response to (c).

(c) No. For those highway transportation costs that are incurred during the test year by trucks which carry no Priority Mail (*i.e.*, for routes within the area served by the new PMPC network), it would seem inequitable to attribute any such costs to Priority Mail. In other words, in order for the TRACS distribution key developed for the base year to be reasonably applicable to the test year, an implicit assumption is that the test year reflects "business as usual" in a manner similar to the base year; *i.e.*, that the operating plan in the test year resembles the operating plan during the base year (see USPS-T-11 for further discussion on the relevance of the operating plan to postal cost determination).

In light of the PMPC contract, this clearly is not the case. The PMPC contract represents a major, material change in the operating plan for the transportation of Priority Mail. During the test year Priority Mail will not incur as large a portion of highway transportation costs as it incurred during the base year, by virtue of the alternate transportation to be provided by Emery. Although this is not an easy issue, it would seem more reasonable to treat the volume diversion as one would any other volume reduction and attribute these costs to the classes and subclasses of mail using highway transportation.

USPS/NDMS-T2-4.

In reference to the implementation of the PMPC contract, on page 78, line 3 of your testimony, you state that "the Postal Service identifies a reduction of approximately $45 million in mail processing direct costs due to the contract", but that "the Postal Service, however, does not identify any reduction in the indirect costs of mail processing (such as supervisor salaries, equipment maintenance personnel, benefits and unemployment compensation, or building rent or utilities). Based on Priority Mail's test year piggyback ratio of 1.559, mail processing cost reductions due to the contract are understated by $25 million." Please also refer to LR H-77, pages 1-3 of the partial response of the United States Postal Service to ANM/USPS-1-17, and the Testimony and Workpapers of Richard Patelunas, USPS-T-15.

(a) Please confirm that the source of the data which results in the 1.559 piggyback factor you have referenced is the Testimony of Richard Patelunas, Exhibit USPS-15E (Cost Segments and Components Report for before rates test year). If you do not confirm, please explain fully and provide the source.

(b) Please confirm that the costs reflected in Exhibit USPS-15E (Cost Segments and Components Report for before rates test year), result from the application of the logic within the rollforward model and not the application of the 1.559 piggyback factor. If you do not confirm, please explain your answer fully.

(c) Please confirm that Exhibit USPS-15E includes the distribution of the indirect costs you have specified to classes, sub-classes and special services. If you do not confirm, please explain your answer fully.

(d) Please confirm that the total amount of costs for Priority Mail in Exhibit USPS 15E is greater than the amount of costs for Priority Mail reflected in Patelunas Workpaper WP-E, Table A (Test Year Before Rates Costs without PESSA), and that the total of all Postal Service costs in both of these reports is the same. If you do not confirm, please explain your answer fully.

Response:

(a) Questions regarding the sources of data found in Postal Service library references, exhibits and workpapers might better be directed to the individuals who prepared them. My source for the piggyback factor was LR-H-77, p. 46.

(b) See response to (a).

(c) Confirmed.

(d) Confirmed.

NDMS/USPS-T2-5.

In reference to the implementation of the PMPC contract, on page 78, line 3 of your testimony, you state that "the Postal Service identifies a reduction of approximately $45 million in mail processing direct costs due to the contract", but that "the Postal Service, however, does not identify any reduction in the indirect costs of mail processing (such as supervisor salaries, equipment maintenance personnel, benefits and unemployment compensation, or building rent or utilities). Based on Priority Mail's test year piggyback ratio of 1.559, mail processing cost reductions due to the contract are understated by $25 million." Please also refer to LR H-77, pages 1-3 of the partial response of the United States Postal Service to ANM/USPS-1-17, and the Testimony and Workpapers of Richard Patelunas, USPS-T-15.

(a) Please confirm that a portion of the difference between Patelunas Exhibit-15E and Patelunas Workpaper WP-E is the result of the Mail Processing Direct Labor (Component 35) distribution key. Additionally, please confirm that the Priority Mail cost in Mail Processing Direct Labor (Component 35) is $45 million less due to the PMPC cost reduction in the rollforward. If you do not confirm either or both statements, please explain fully.

Response:

(a) Based on the analysis contained in this interrogatory, it appears that the indirect costs discussed in my testimony have been captured in the rollforward model. Accordingly, I will withdraw the related portion of my testimony, p. 77, l. 15 to p. 78, l. 10.

DECLARATION

I, John Haldi, declare under penalty of perjury that the foregoing answer is true and correct to the best of my knowledge, information and belief.

John Haldi

John Haldi

Dated: January 26, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.

William J. Olson

William J. Olson

January 26, 1998